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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 500

THE CROWELL-COLLIER PUBLISHING CO.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Crowell-Collier Publishing Company prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled case on October 7, 1958.

Citation to Opinions Below

The opinion of The Tax Court in this proceeding involves Federal income and excess profits taxes for the calendar years 1943 and 1944, Federal excess profits taxes for the calendar year 1945, and the composition of the excess profits credit for the calendar years 1940

through 1945, inclusive, under Section 722 I. R. C. 1939. The opinion of The Tax Court appears in 25 T. C. 1268[1] and is printed in the Court of Appeals Record, page 3057a, ff.

The findings of fact of The Tax Court appear in Tax Court Memorandum Decision 21644(M) and are printed in the Court of Appeals Record, pages 2977a to 3056a.

The opinion of the United States Court of Appeals is printed in Appendix B hereof, *infra*, page 29, and is reported in — Fed. 2d —.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on October 7, 1958. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

Questions Presented

Three separate and distinct questions are presented for review.

I

Power of the Court of Appeals to review where The Tax Court made arbitrary ultimate findings inconsistent with its specific findings.

Does the Court of Appeals have power to review a decision of The Tax Court in a case arising under

[1] The Tax Court's order denying petitioner's motion to correct the opinion is not officially reported. It is printed in the Court of Appeals record, pages 3114a to 3115a. Petitioner's motion to correct the opinion of The Tax Court is printed in the Court of Appeals record, pages 3081a to 3113a.

Section 722, Internal Revenue Code of 1939, where The Tax Court, in granting petitioner relief on two issues, made arbitrary ultimate findings inconsistent with favorable detailed evidentiary findings?

II

Power of the Court of Appeals to review where The Tax Court reached certain conclusions without making supporting findings of fact.

Does the Court of Appeals have power to review a decision of The Tax Court in a case arising under Section 722, Internal Revenue Code of 1939, where The Tax Court, in granting petitioner relief on two issues, reached certain conclusions without making findings of fact in support thereof?

III

Repeal of Section 732(c) I. R. C. 1939

Was Section 732(c), Internal Revenue Code of 1939, which denies appellate review of cases where the determination of any question is necessary "solely" because of Sections 711(b), 721, and 722, repealed by the Internal Revenue Code of 1954?

Statutes Involved

The statutory provisions involved are as follows:

With respect to questions I and II, Section 732(c) of the Internal Revenue Code of 1939, and Sections 7459(b) and 7482 of the Internal Revenue Code of 1954;

With respect to question III, Section 732(c) of the Internal Revenue Code of 1939, and Section 7851(a)(6) and 7851(a)(7) of the Internal Revenue Code of 1954.

They are printed in Appendix A, *infra*, pages 19 to 28.

Statement

The basis of the jurisdiction of the court of first instance, The Tax Court of the United States, was a petition filed pursuant to Section 732 of the Internal Revenue Code of 1939.

The case with respect to each of the questions presented is as follows:

I

Power of the Court of Appeals to review where The Tax Court made arbitrary ultimate findings inconsistent with its specific findings.

Petitioner's contention is that the Court of Appeals has power to review a decision of The Tax Court where The Tax Court made arbitrary ultimate findings inconsistent with its specific findings.

The Court of Appeals held that it is prohibited by Section 732(c) of the Internal Revenue Code of 1939 from reviewing The Tax Court's determination.

The facts pertaining to this question are as follows:

Petitioner is a nationally known corporation which, during the years 1936 to 1939, inclusive, was engaged in the publication and sale of magazines. These magazines were: Collier's, The National Weekly, Woman's Home Companion, The American Magazine, and Country Home. In each of these years, Country Home showed a substantial loss, and its publication was discontinued with the December, 1939, issue. A substantial saving in petitioner's annual expenses was achieved thereby.

Prior to the year 1936, petitioner used the letterpress method for printing its magazines. During the years 1936 through 1939, it changed, to a substantial degree, to the gravure method of printing. This change effected a considerable cost saving.

The Tax Court found that both of these factors qualified petitioner for relief under Section 722, and increased petitioner's average base period net income by $518,000.00.

Petitioner thereupon made a motion to correct and revise the opinion of The Tax Court, in which it urged that the ultimate finding of a constructive increase in average base period net income of $518,000.00 was inconsistent with the specific evidentiary findings on the two qualifying factors found by the court (3081a to 3113a). Petitioner urged that The Tax Court make an ultimate finding of an increase in average base period net income of $822,837.78, which was consistent with the specific evidentiary findings of the court on the two qualifying factors. The Tax Court denied petitioner's motion.

II

Power of the Court of Appeals to review where The Tax Court reached certain conclusions without making supporting findings of fact.

Petitioner's contention is that the Court of Appeals has the power to review a decision of The Tax Court where The Tax Court reached certain conclusions without making supporting findings of fact.

The Court of Appeals held that it is prohibited by Section 732(c) of the Internal Revenue Code of 1939 from reviewing The Tax Court's determination.

The facts pertaining to this question are as follows:

The Tax Court made the following ultimate finding of fact:

> "A fair and just amount to represent petitioner's constructive average base period net income is $518,000 in excess of its average base period net income, after adjustments already allowed in the deficiency notice under section 711." (3056a)

This ultimate finding of fact was repeated by The Tax Court in its opinion (3072a).

Following the restatement of its ultimate finding of fact in the opinion, The Tax Court stated:

> "Our reconstruction under which we have reached the CABPNI shown in our ultimate findings has been made upon consideration of the entire record."

The Tax Court referred to its reconstruction at two other points in the opinion (3062a, 3071a).

Petitioner, in its motion to correct the opinion of The Tax Court, urged that court to correct and revise its opinion, and submit a reconstruction based upon The Tax Court's evidentiary findings.

The Tax Court denied petitioner's motion to correct its opinion.

Petitioner, on appeal to the Court of Appeals, urged that under Section 7459(b), Internal Revenue Code of 1954, The Tax Court was required to "report in writing all its findings of fact", and urged that the case be remanded to The Tax Court with directions either to accept petitioner's computation of a reconstruction (3081a-3113a) or to revise its findings by including therein The Tax Court's own reconstruction.

This the Court of Appeals did not do, ignoring Section 7459(b), Internal Revenue Code of 1954, and stating that it had no jurisdiction under Section 732(c), Internal Revenue Code of 1939. The Court of Appeals dismissed the appellant's petition for review in this proceeding on this issue.

III

Repeal of Section 732(c), Internal Revenue Code of 1939.

Petitioner contends that Section 7851(a)(6)(C) and (a)(7), Internal Revenue Code of 1954, repealed Section 732(c), Internal Revenue Code of 1939.

The Court of Appeals held that Section 732(c) still applies with respect to review of World War II

excess profits tax relief proceedings, citing *Brown Paper Mill Co., Inc.* v. *Commissioner* (CA-5, 1958) 255 Fed. 2d 77 (Certiorari pending).

Reasons for Granting the Writ

I. On the Question Whether the Court of Appeals Has the Power to Review Where The Tax Court Made Arbitrary Ultimate Findings Inconsistent With Its Specific Evidentiary Findings.

A. There Is A Direct Conflict Among Circuits.

The decision of the Court of Appeals to the effect that it is prohibited by Section 732(c), Internal Revenue Code of 1939, from reviewing the decision of The Tax Court below is in direct conflict with a decision of the Court of Appeals for the Ninth Circuit. *Helms Bakeries* v. *Commissioner* (CA-9, 1956) 236 Fed. 2d 3 (printed in Appendix C). This same question is presently before this Court in *Brown Paper Mill Co., Inc.* v. *Commissioner* (CA-5, 1958) 255 Fed. 2d 77, on petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit.

In *Helms Bakeries* v. *Commissioner*, petitioner requested the Court of Appeals for the Ninth Circuit to review a decision of The Tax Court. The Court of Appeals held that where taxpayer sought adjustment in excess profits tax upon the basis of a change in its operative and productive capacity occurring within the base period, and The Tax Court found there was a change in the productive capacity, it should also have made a finding as to "whether or not, if this increase in capacity for operation had been made two years earlier, a higher level of earnings would have

been reached at the end of the base period, and if so, the amount thereof." On this issue the case was remanded to The Tax Court.

The conflict between the Ninth Circuit and the Fifth Circuit was called to the attention of the Court of Appeals below on argument, both by counsel for petitioner and respondent. Although the *Helms Bakeries* case was cited frequently by both sides in the briefs, the Court of Appeals in its opinion did not cite or distinguish *Helms Bakeries* v. *Commissioner, supra.*

In the *Helms* case it was contended, as in the case at bar, that the ultimate finding of The Tax Court was contrary to the evidentiary findings. In that case, respondent contended that Section 732(c) denied the Court of Appeals the power to take jurisdiction. The basis of respondent's contention was that the determination of the question was necessary "solely" because of Section 722. Nevertheless, the Ninth Circuit states on page 9 of its opinion: "In view of the evidentiary findings of the Tax Court on this subject, its conclusion 'lack of productive capacity was not a factor which to any appreciative extent limited petitioner's sales' appears to be arbitrary and contrary to its own findings."

The Court of Appeals then concluded: "In light of the foregoing record in respect to relief sought by the petitioner under Section 722(b)(4), we are not precluded from assuming jurisdiction because of the provisions of Section 732(c)."

The issue before the Court of Appeals in the instant case did not arise "solely" because of Section 722. In

its petition seeking review, the taxpayer contended, as it contends here, that the Court of Appeals has jurisdiction to review a decision of The Tax Court under Section 7482, Internal Revenue Code of 1954, where the ultimate finding of the lower court is arbitrary and inconsistent with the court's specific evidentiary findings.

In his brief, respondent recognizes the decision of the Ninth Circuit and argued that it was erroneous. This is the same contention made by respondent on brief in *Brown Paper Mill Co., supra.*

Petitioner contends that the Second Circuit stretched the word "solely" far beyond any reasonable or established meaning of that word.[1] When an administrative tribunal or a court arbitrarily finds ultimate facts inconsistent with its evidentiary findings, such action is not due "solely" to the Statute under which the action arose. In the present case the petitioner accepts all the evidentiary findings of The Tax Court. A fair reading of those findings, resolving any doubt in favor of the respondent, shows that the ultimate finding is clearly arbitrary and inconsistent with the evidentiary findings.

The Court of Appeals which declined to take jurisdiction over this issue on the ground that it arose "solely" from Section 722, nevertheless took jurisdiction over petitioner's challenge to Commissioner's Regulation 112, 35.722-3(d)(5). On that issue, petitioner urged that the Commissioner's Regulation was

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[1] The word "solely" should be given only that limited meaning as it is given in the Report of the Ways and Means Committee (77th Cong., 1st Sess., H. Rept. 146) printed in Appendix A, hereof, *infra*, page 26.

not based on the Statute and was therefore invalid. Here the Court of Appeals affirmed The Tax Court's application of the "Variable Credit Rule". It did *not* dismiss for lack of jurisdiction. See *May Seed & Nursery Co.* v. *Commissioner* (CA-8, 1957) 242 Fed. 2d 151, cert. denied 355 U. S. 839, where the 8th Circuit also took jurisdiction over an appeal involving the correctness of regulations under Section 722 and affirmed but did not dismiss. Petitioner contends that on this issue the Court of Appeals more properly could have declined to take jurisdiction rather than on the question of whether or not the ultimate finding was arbitrary and inconsistent with the evidentiary findings.

The decisions of three Courts of Appeals, i.e., Second, Fifth, and Ninth, are in direct conflict, and the question should be resolved.

B. An Important Question of Federal Law Not Heretofore Decided By This Court Is Involved.

This question is one of importance because of the large volume of excess profits tax relief claims pending before the Treasury Department and before The Tax Court of the United States.[1] The conflict of decisions among the lower courts on this point of Federal law accordingly should be resolved so that the application of the Statute will be uniform throughout the United States as required under Article I, Section 8, Clause 1, of the Constitution.

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[1] Petitioner's counsel has been advised that there are approximately 150 cases submitted, but undecided by The Tax Court, and approximately 75 more cases awaiting trial. Counsel is not informed of the number of excess profits tax relief claims still in the prelitigation or administrative stage.

C. There Is a Conflict With the Rule of *United States* v. *California Eastern Line* (1954) 348 U. S. 351.

This Court in *United States* v. *California Eastern Line* (1954) 348 U. S. 351 passed on the analogous question of the power of the Courts of Appeals to review The Tax Court of the United States in renegotiation cases. Congress had designated The Tax Court to determine "excessive profits" under the Renegotiation Act of 1942.[1] Congress the same year had also designated The Tax Court to determine the converse: whether the excess profits tax computed without the benefits of Section 722 of the Excess Profits Tax Act of 1942 is "excessive". The two statutory provisions are thus the converse sides of the same coin.

The restriction imposed by Congress on review of The Tax Court by the Courts of Appeals under the Renegotiation Act is contained in Section 403(e)(1) of that Act. The restriction imposed by Congress on review of The Tax Court under the Excess Profits Tax Act is contained in Section 732(c) of that Act. They are parallel.

The Renegotiation Act prohibits review of the *amount* of excessive profits. The Excess Profits Tax Act prohibits review of questions arising *solely* out of Section 722. Other issues arising out of renegotiation proceedings are reviewable. *United States* v.

[1] 56 Stat. 245, as amended, 50 U. S. C. A. app. Sec. 1191. Section 403(e)(1) reads in part: "Upon such filing such court shall have exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency."

California Eastern Line (1954) 348 U. S. 351 at 355. Other issues arising out of the excess profits tax relief proceedings should, under the rationale of the cited case, be reviewable. *Helms Bakeries* v. *Commissioner* (CA-9, 1956) 236 Fed. 2d 3.

There should be no cutting off of judicial review of administrative agencies unless required by the statute. *Brownell* v. *Tom We Shung* (1956) 352 U. S. 180. *Shaughnessy* v. *Pedreiro* (1955) 349 U. S. 48. Administrative Procedure Act Section 10(a), 60 Stat. 243 (1946), 5 U. S. C. Section 1009(a) (1952). The Tax Court is an administrative agency (not a part of the judicial system). *Katz* v. *Commissioner* (CA-2, 1951) 188 Fed. 2d 957, *Lincoln Electric Co.* v. *Commissioner* (CA-6, 1947) 162 Fed. 2d 379, *Lasky* v. *Commissioner* (CA-9, 1956) 235 Fed. 2d 97, affirmed per curiam (1957) 352 U. S. 1027.

Judicial review should not be cut off in this case, since as shown in Point I (A), the issue did not arise "solely" because of any question of the right to relief under Section 722, but rather the duty of The Tax Court to comply with Section 7459(b) by making all of its findings in writing to support its reconstruction of petitioner's base period normal earnings, which are consistent among themselves.

II. On The Question Whether The Court of Appeals Has The Power To Review Where The Tax Court Reached Certain Conclusions Without Making Supporting Findings of Fact.

A. There Is A Conflict Among Circuits.

The decision of the Court of Appeals to the effect that it is prohibited by Section 732(c), Internal Revenue Code of 1939, from reviewing a decision of The Tax Court below is in direct conflict with a decision of the Court of Appeals for the Ninth Circuit in *Helms Bakeries* v. *Commissioner, supra*. This question is presently before this Court in *Brown Paper Mill Co. Inc.* v. *Commissioner, supra*, on petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit.

The issue under this question arises from the Court of Appeals' failure to take jurisdiction on the ground that Section 732(c), Internal Revenue Code of 1939, prohibits a review of Tax Court decisions arising "solely" because of the abnormalities sections of the excess profits tax law, i. e., Sections 711, 721, and 722. Since this question is similar to the question presented as Question I hereof, petitioner will not unduly burden this Court with a restatement of the argument and contentions under Question I.

Petitioner's argument and contentions under Question I apply here.

B. An Important Question of Federal Law, Not Heretofore Decided By This Court, Is Involved.

This question is one of importance because of the large volume of excess profits tax relief claims pending before the Treasury Department and before The Tax Court of the United States.[1] The conflict of decisions among the lower courts on this point of Federal law should accordingly be resolved so that the application of the statute will be uniform throughout the United States, as required by Article I, Section 8, Clause 1 of the Constitution.

III. Repeal of Section 732(c), Internal Revenue Code of 1939.

A. In the Internal Revenue Code of 1954, Congress Repealed Section 732(c), Internal Revenue Code of 1939.

The decision of the Court of Appeals stated that the enactment of the Internal Revenue Code of 1954 did not repeal the prohibition against review of decisions of The Tax Court based on abnormalities contained in Section 732(c) of the 1939 Code. This decision is in conflict with the explicit language of the Internal Revenue Code of 1954.

Section 7851(a)(6)(C) thereof provides:

> "After the date of the enactment of this title, the following provisions of subtitle F shall apply to taxes imposed by the Internal Revenue Code of 1939 notwithstanding any contrary provisions of such code:
>
> * * * *

[1] See Footnote on page 11.

(iv) Chapter 76, relating to judicial proceedings."

Chapter 76 contains the provisions governing the Court of Appeals review of Tax Court decisions. Section 7851(a)(7) thereof reads in part:

> "If the repeal of any provisions of the Internal Revenue Code of 1939 is not otherwise provided by this section or any other section of this title, *such provision is hereby repealed,* effective on the day after the date of enactment of this title." (Emphasis supplied.)

Contrary to the decision of the Court of Appeals, petitioner contends that the language of Congress is clear and explicit.

The Court of Appeals based its decision in part on the legislative history of Sections 7482 and 7483 which it interpreted to show that Section 732(c) still applies with respect to review of World War II excess profits tax relief proceedings. Petitioner submits that these sections of the 1954 code, i. e., Sections 7482, and 7483, neither support nor controvert the ruling of the Court of Appeals that Section 732(c) still applies to proceedings arising from Section 722.

As in the petition of *Brown Paper Mill Co.* for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit, petitioner respectfully urges that the repeal of Section 732(c) by Section 7851, Internal Revenue Code of 1954, is supported by the action of the legislature on S. 984, passed by the Senate on March 30, 1953, which provided for Court of Appeals review in such cases.

The bill was sponsored by the American Bar Association and approved by the Treasury Department. (Senate Report No. 116, 83rd Congress, 1st Session). A principal reason advanced for the enactment of the bill was that taxpayers were successful with respect to about 50 percent of the money involved in standard issue cases decided by The Tax Court which were subject to judicial review. Taxpayers were successful in securing the refund of only about 2 percent of the money involved in excess profits tax relief cases, which were not subject to judicial review. (Hearings before a Subcommittee of the Committee on the Judiciary, United States Senate, 83rd Congress, 1st Session, on S. 984, pages 2, 3, and 7). The bill was favorably reported to the House by the Judiciary Committee on the same day H. R. 8300, which was to become the 1954 Code, passed the House. No further action was taken on S. 984. The only inference which can be drawn from this failure of the House to act on a bill which had passed the Senate and which had been favorably reported to the House was that the House believed the situation was covered by the Internal Revenue Code. The language of the 1954 Code justifies this assumption.

B. An Important Question of Federal Law Not Heretofore Decided By This Court Is Involved.

This question is one of importance because it is pending before this Court in *Brown Paper Mill Co., Inc.* v. *Commissioner, supra,* and before the Court of Appeals for the Ninth Circuit on the second appeal of *Helms Bakeries Co.* v. *Commissioner, supra.*

It is important also because of the large number of excess profits tax relief claims still pending before the Treasury Department and before The Tax Court of the United States.

CONCLUSION

For the foregoing reasons this Petition For A Writ Of Certiorari should be granted.

Respectfully submitted,

JAY O. KRAMER
Counsel for Petitioner

Dated: November 6, 1958

Appendix A

THE INTERNAL REVENUE CODE OF 1939

SEC. 722. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

* * * *

(b) *Taxpayers Using Average Earnings Method.*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

* * * *

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time. For the purposes of this subparagraph, the term "change in the character of the business" includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the

capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business, with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business.

* * * *

SEC. 732. REVIEW OF ABNORMALITIES BY BOARD OF TAX APPEALS

* * * *

(c) *Finality of Determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Board.

Appendix A

THE INTERNAL REVENUE CODE OF 1954

SEC. 7459. REPORTS AND DECISIONS.

* * * *

(b) *Inclusion of Findings of Fact or Opinions in Report.*—It shall be the duty of the Tax Court and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Tax Court shall report in writing all its findings of fact, opinions, and memorandum opinions.

SEC. 7482. COURTS OF REVIEW

(a) *Jurisdiction.*—The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

(b) *Venue.*—

(1) IN GENERAL.—Except as provided in paragraph (2), such decisions may be reviewed by the United States Court of Appeals for the circuit in which is located the office to which was made the return of the tax in respect of which

the liability arises, or, if no return was made, then by the United States Court of Appeals for the District of Columbia.

(2) BY AGREEMENT.—Notwithstanding the provisions of paragraph (1), such decisions may be reviewed by any United States Court of Appeals which may be designated by the Secretary or his delegate and the taxpayer by stipulation in writing.

(*c*) *Powers.*—

(1) TO AFFIRM, MODIFY, OR REVERSE.—Upon such review, such courts shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require.

(2) TO MAKE RULES.—Rules for review of decisions of the Tax Court shall be those prescribed by the Supreme Court under section 2074 of Title 28 of the United States Code. Until such rules become effective the rules adopted under authority of section 1141(*c*)(2) of the Internal Revenue Code of 1939 shall remain in effect.

(3) TO REQUIRE ADDITIONAL SECURITY.—Nothing in section 7483 shall be construed as relieving the petitioner from making or filing such undertakings as the court may require as a condition of or in connection with the review.

(4) To impose damages.—The United States Court of Appeals and the Supreme Court shall have power to impose damages in any case where the decision of the Tax Court is affirmed and it appears that the petition was filed merely for delay.

Sec. 7851. Applicability of Revenue Laws

(a) *General Rules.*—Except as otherwise provided in any section of this title—

* * * * *

(6) Subtitle F.—

(A) General rule.—The provisions of subtitle F shall take effect on the day after the date of enactment of this title and shall be applicable with respect to any tax imposed by this title. The provisions of subtitle F shall apply with respect to any tax imposed by the Internal Revenue Code of 1939 only to the extent provided in subparagraphs (B) and (C) of this paragraph.

(B) Assessment, collection, and refunds.—Notwithstanding the provisions of subparagraph (A), and notwithstanding any contrary provision of subchapter A of chapter 63 (relating to assessment), chapter 64 (relating to collection), or chapter 65 (relating to abatements, credits, and refunds) of this title, the provisions of part II of subchapter A of chapter 28 and chapters 35, 36, and 37 (except section 3777) of subtitle D of the Internal Revenue Code of 1939 shall remain

in effect until January 1, 1955, and shall also be applicable to the taxes imposed by this title. On and after January 1, 1955, the provisions of subchapter A of chapter 63, chapter 64, and chapter 65 (except section 6405) of this title shall be applicable to all internal revenue taxes (whether imposed by this title or by the Internal Revenue Code of 1939), notwithstanding any contrary provision of part II of subchapter A of chapter 28, or of chapter 35, 36, or 37, of the Internal Revenue Code of 1939. The provisions of section 6405 (relating to reports of refunds and credits) shall be applicable with respect to refunds or credits allowed after the date of enactment of this title, and section 3777 of the Internal Revenue Code of 1939 is hereby repealed with respect to such refunds and credits.

(C) TAXES IMPOSED UNDER THE 1939 CODE.—After the date of enactment of this title, the following provisions of subtitle F shall apply to the taxes imposed by the Internal Revenue Code of 1939, notwithstanding any contrary provisions of such code:

(i) Chapter 73, relating to bonds.

(ii) Chapter 74, relating to closing agreements and compromises.

(iii) Chapter 75, relating to crimes and other offenses, but only insofar as it relates to offenses committed after the date of enactment of this title, and in the case of such offenses, section 6531, relating to periods of limitation

on criminal prosecution, shall be applicable. The penalties (other than penalties which may be assessed) provided by the Internal Revenue Code of 1939 shall not apply to offenses committed after the date of enactment of this title, to which chapter 75 of this title is applicable.

(iv) Chapter 76, relating to judicial proceedings.

(v) Chapter 77, relating to miscellaneous provisions, except that section 7502 shall apply only if the mailing occurs after the date of enactment of this title, and section 7503 shall apply only if the last date referred to therein occurs after the date of enactment of this title.

(vi) Chapter 78, relating to discovery of liability and enforcement of title.

(vii) Chapter 79, relating to definitions.

(viii) Chapter 80, relating to application of internal revenue laws, effective date, and related provisions.

(D) CHAPTER 28 AND SUBTITLE D OF 1939 CODE.—Except as otherwise provided in subparagraphs (B) and (C), the provisions of chapter 28 and of subtitle D of the Internal Revenue Code of 1939 shall remain in effect with respect to taxes imposed by the Internal Revenue Code of 1939.

(7) OTHER PROVISIONS.—If the effective date of any provision of the Internal Revenue Code of 1954 is not otherwise provided in this section or in any other section of this title, such provision shall take effect on

the day after the date of enactment of this title. If the repeal of any provision of the Internal Revenue Code of 1939 is not otherwise provided by this section or by any other section of this title, such provision is hereby repealed effective on the day after the date of enactment of this title.

* * * *

Ways and Means Committee Report (77th Cong., 1st Sess., H. Rept. 146)

REPORT—WAYS AND MEANS COMMITTEE (77th Cong., 1st Sess., H. Rept. 146).—

Section 9 of the bill (adding sec. 732 to the Excess Profits Tax Act of 1940) extends to the Board exclusive jurisdiction to review the Commissioner's decision upon any question the determination of which is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721 or 722. For example, an item of income of $100,000, the amount of which is not in dispute, is includible in gross income for 1940 and involves a question concededly arising under section 721 (a) (2) (A). The Commissioner determines that the item is attributable to 1939 and 1940 in the respective sums of $25,000 and $75,000. Such determination is made upon an issue arising solely under section 721 and, if the taxpayer contests such allocation, the determination of the Commissioner in such case is reviewable only by the Board. If, however, the Commissioner determines, for example, the amount of income derived by a taxpayer from a transaction

falling within section 721 (a) (2) (E), relating to amounts included in gross income for the taxable year by reason of the termination of a lease of real property, and the amount so determined is contested by the taxpayer, the question as to amount of such income is not one arising solely by reason of the abnormality provisions but independently of them and hence review of the determination as to the amount in such a case is not confined to the Board.

Likewise, review is not confined to the Board if, for example, the Commissioner determines that the taxpayer realized in 1940 income of a character which, if realized in that year, would fall within section 721 (a) (2) (A) but which the taxpayer contends was realized in 1939. In such case the question whether income was so realized in 1940 may be reviewed by the courts upon appeal from the decision of the Board. Assuming in such case that it is ultimately held that the income was realized in 1940, a dispute as to the resulting question of allocation as between years of such item may not be carried beyond the Board.

Under existing law, unless a deficiency has been determined by the Commissioner, a taxpayer has no right of appeal to the Board (sec. 272 (a) (1), I. R. C.). Thus, for example, if a refund claim were filed by a taxpayer and the Commissioner disallowed the claim in whole or in part but did not determine deficiency, no right of review of the Commissioner's action by the Board would be present. Inasmuch as the taxpayer's right to relief under certain of the relief provisions provided in this bill may only be

raised by a claim for refund, it is necessary that a procedure be provided whereby the Board may obtain jurisdiction to review a decision by the Commissioner disallowing such claims. Accordingly, section 732 (added to the Excess Profits Tax Act of 1940 by sec. 9 of the bill) provides that the taxpayer may file a petition with the Board of Tax Appeals within 90 days after notice of such disallowance is mailed for redetermination of the excess-profits tax. If such petition is filed such notice of disallowance is deemed to constitute a notice of deficiency for the purposes of assessment and collection of any deficiencies and the credit or refund of overpayments (including the suspension of the statute of limitations with respect thereto). If such appeal is taken, then all pertinent issues bearing upon the tax liability under chapter 2E may be raised by the taxpayer and reviewed by the Board. (pp. 14-15)

Appendix B

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 52—October Term, 1957.

(Argued May 8, 1958 Decided October 7, 1958.)

Docket No. 24497

THE CROWELL-COLLIER PUBLISHING COMPANY,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Before:

WATERMAN and MOORE, *Circuit Judges*, and GALSTON, *District Judge*.

Petition for review of an order of the Tax Court, Eugene Black, *Judge*, 25 Tax Court 1268, determining deficiencies in income taxes and excess profits taxes. Affirmed.

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GALSTON, *District Judge*:

This is a petition for review of a decision of the Tax Court of the United States determining taxpayer's income tax liability for the calendar years 1943 and 1944, and excess profits tax liability for the calendar years 1943, 1944 and 1945.

Petitioner, a Delaware corporation, during the years 1936 through 1939 inclusive, was a publisher of four national magazines, one of which was Country Home. In each of these years Country Home showed a substantial loss, and at the end of 1939 its publication was discontinued. A substantial saving in petitioner's annual expenses was achieved thereby.

Prior to the year 1936 petitioner used the letterpress method for printing its magazines. During the years 1936 through 1939 it changed to a substantial degree to the gravure method of printing. This change effected a considerable saving.

In February of 1952 the Commissioner of Internal Revenue assessed a deficiency in petitioner's excess profits tax liability for the years 1943 through 1945 totaling $1,866,250.35. Petitioner filed with the Tax Court a petition for revision claiming an overassessment for those years.

In the Tax Court petitioner raised several issues:

1. Whether petitioner was entitled to relief under § 722(b)(4) of the 1939 Code on the ground that its average base period net income was an inadequate standard of normal earnings because of the discontinuance at the end of the base period of its unprofitable magazine, Country Home.

2. Whether petitioner was entitled to relief under § 722(b)(4) on the ground that its average base period net income was an inadequate standard of normal earnings because of savings it realized due to changes which it made during the base period from the letterpress method of printing to a substantial use of the high-speed multicolor gravure method of printing.

3. Questioning the determination of petitioner's adjusted ("constructive") average base period net income resulting from both or either of the qualifying factors set forth above.

4. Whether petitioner is entitled under § 721 of the Code to eliminate abnormal income resulting from gravure research and development.

5. Whether petitioner is entitled under § 711 of the Code to eliminate certain abnormal expenses incurred during the base period.

To the first, second and third questions the Tax Court answered in favor of petitioner and held that petitioner's income average for the applicable base period should be adjusted upwards by $518,000.

As to the fourth and fifth issues the Tax Court held for the Commissioner. The Court found that petitioner had not incurred research and development costs entitling it to relief under § 721. As to the fifth issue the Tax Court held that the expenses which petitioner sought to eliminate from the computation of the base period were not of "abnormal" nature within the purview of § 711.

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On appeal to this court petitioner raises the following questions:

1. Whether in determining the amount of relief from excess profits taxes under § 722(b)(4) the Tax Court acted arbitrarily in that it allowed an amount of relief which was inconsistent with the court's specific findings of fact.

2. Whether the Tax Court erred in holding that a certain portion of the expenses allocated to Country Home magazine would have continued after cessation of its publication.

3. Whether the Tax Court erred in concluding that the taxpayer was not entitled to any relief under § 721 with respect to "abnormal" income allegedly received during the taxable year as the result of expenditures made during the base period years for research and development in the art of gravure printing.

4. Whether the Tax Court erred in failing to include in its decision specific determinations of an over-assessment of income tax for the year 1942, and an over-assessment in declared value excess profits taxes for 1944 where no deficiency with respect to those two taxes had been determined by the Commissioner.

5. Whether the Tax Court in determining the amount of relief granted to the taxpayer under § 722 erred in using the so-called "variable credit rule" contained in respondent's regulations.

6. Whether the Tax Court erred in concluding that the taxpayer was not entitled to any relief under § 711(b)(1)(J) for certain "abnormal deductions."

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Other issues raised by petitioner have been conceded by respondent and will not be considered here.

The Excess Profits Tax Act of 1940 (§ 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974) imposed an excess profits tax upon certain corporations for taxable years beginning after December 31, 1939. The tax was imposed on net income (modified by certain adjustments) in excess of a specific exemption of $5,000, and a norm or standard referred to as "the excess profits credit."

In computing its tax the petitioner used what is referred to as the "average income method." This method provides for the computation of the general average of the excess profits net income for taxable years beginning with the four base period years of 1936 to 1939 inclusive. The excess profits credit is 95% of such base period average income.

The 1940 Act contained two relief provisions: § 721 and § 722 of the Internal Revenue Code of 1939. § 721 provided relief for corporations which had received abnormal income in an excess profits tax year if the taxpayer could demonstrate that such abnormal income was attributable to events in other taxable years. The abnormal income was defined to mean income of exceptional type or magnitude which the taxpayer did not usually receive. If items of abnormal income could be attributed to other years in the light of the events in which such items had their origin, such abnormal income was pushed back or forward to such other years.

Code § 722, on the other hand, provided relief when the abnormalities were in the base period, either in form of low income or high deductions arising from

certain specific causes. The section permits taxpayers to increase their excess profits credit by upward adjustments of their average base period net income to compensate for changes in the character of business occurring before January 1, 1940. Sec. 722 applies when the taxpayer can demonstrate that if certain changes in his business which occurred towards the end of the base period had occurred at the beginning of such period the average income level used to compute the excess profits tax credit would have been larger than the average income actually realized.

By its petition for review the taxpayer is endeavoring to present to this court on appeal issues decided by the Tax Court with respect to taxpayer's right to relief under the two "abnormalities" sections described above as well as § 711(b)(1)(J) of the 1939 Code in regard to its excess profits tax liability for the taxable years in question.

At the outset respondent challenges this court's jurisdiction to review the decision of the Tax Court with respect to the taxpayer's right to relief under § 722, § 721 or § 711(b)(1)(J). In this, respondent relies on § 732(c) which provides as follows:

> "(c) *Finality of Determination*—if in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of § 711(b)(1)—(J)—, § 721 or § 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Tax Court."

In an effort to avoid the effect of the prohibition of review contained in § 732(c) the taxpayer in its peti-

tion seeking review has asserted *jurisdiction under* § 7482 and § 7483 of the 1954 Code.* The taxpayer offers no explanation in support of its assertion of jurisdiction under these sections. Its contention must be that the enactment of the 1954 Code operates to confer jurisdiction upon this court to review decisions of the Tax Court on "abnormalities" issues, apparently upon the theory that the 1954 Code repealed the prohibition against such reviews contained in § 732(c) of the 1939 Code. However, neither the text nor the legislative history of § 7482 and § 7483 sustains the taxpayer's contention, but rather they show that § 732(c) still applies with respect to review of World War II excess profits tax relief proceedings. See *Brown Paper Mill Co., Inc.* v. *Commissioner* (5 Cir. May 8, 1958) (not yet reported).

Inasmuch as § 732(c) expressly and without any exception or qualification prohibits any review or redetermination by any court other than the Tax Court of any question "solely by reason of" § 722, § 721 or § 711(b)(1)(J) or (K)—the "abnormalities" provisions of the Excess Profits Tax Act—this court must decline to entertain the taxpayer's petition for review in this proceeding, and dimiss the appeal insofar as it relates to the questions arising and determined under those sections. The causes in which appellate courts have entertained reviews involving "abnormalities" fall into two categories. One comprises the so-called "standard issues." These are cases in which the Tax Court had decided that it had no jurisdiction to entertain "standard issues" in such a proceed-

* See Appendix (A).

ing. See *Martin Weiner Corporation* v. *Commissioner*, 233 F. 2d 444 (2 Cir. 1955); *Commissioner* v. *Blue Diamond Coal Co.*, 230 F. 2d 312 (6 Cir. 1956); *Commissioner* v. *S. Frieder & Sons Co.*, 228 F. 2d 478 (3 Cir. 1955); *Commissioner* v. *Seminole Manufacturing Co.*, 233 F. 2d 395 (5 Cir. 1956), and cases cited therein.

The second category of cases in which appellate courts have reviewed a determination of the Tax Court on "abnormalities" issues involves what may be called "combination questions." The Tax Court's decisions were reviewed because they were regarded as presenting determinations turning on other provisions in addition to the "abnormalities" sections. See *Dowd-Feder, Inc.* v. *Commissioner*, 173 F. 2d 673 (6 Cir. 1949); *Dayton Rubber Co.* v. *Commissioner*, 249 F. 2d 2 (6 Cir. 1957).

The present petition does not seek review of questions falling within either of these two categories. In particular, the questions could not be regarded as falling in the category of "combination questions." Each of the "abnormalities" questions presented here was decided by the Tax Court exclusively and solely by reason of § 721, § 722 or § 711(b)(1)(J). In these circumstances § 732(c) of the 1939 Code prohibits us from reviewing the Tax Court's determination. And it makes no difference that both questions of law and of fact may be involved if the determination of the Tax Court is solely by reason of the "abnormalities" provisions. See *George Kemp Real Estate Co.* v. *Commissioner*, 182 Fed. 2d 847 (2 Cir. 1950).

In its petition for review the taxpayer alleges that the Tax Court erred in failing to include in its deci-

sion specific determinations of an over-assessment of income tax for the year 1942 and an over-assessment in declared value excess-profits taxes for 1944, even if no deficiency with respect to those two taxes had been determined by the Commissioner. On this point respondent concedes the jurisdiction of this court.

However, in the notice to the petitioner, the Commissioner found an over-assessment of income tax and declared value excess-profits tax for the years 1942 and 1944. Petitioner did not file a formal claim for refund with respect to those years. Nevertheless, petitioner now urges that the Tax Court erred in not finding an over-assessment with respect to those years.

On this point petitioner relies on § 6512(b)(1)* of the 1954 Code, which provides as far as relevant here that whenever there is a deficiency of income tax before the Tax Court for a given year, that court must find the correct income tax liability whether it results in a greater deficiency or an over-assessment.

Undoubtedly the Tax Court has the power to redetermine the correct tax to the extent that its jurisdiction has been properly invoked, whether such redetermination results in a deficiency or an over-assessment. See *Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716 (1928). But the taxpayer can invoke the jurisdiction of the Tax Court only when the Commissioner has determined a deficiency. See §§ 6212 and 6213 of the 1954 Code; *Uncasville Mfg. Co.* v. *Commissioner*, 55 F. 2d 893 (2 Cir. 1932). The Tax Court's authority to find an overpayment applies to taxes of

* See Appendix (B).

the same kind with respect to which a deficiency has been determined by the Commissioner. This court has held that on petition to the Tax Court to review a determination of a deficiency in ordinary income taxes the Tax Court was without jurisdiction to redetermine taxpayer's excess profits taxes with respect to which no deficiency had been determined. *Super Heater Co.* v. *Commissioner*, 125 F. 2d 514 (2 Cir. 1942). The holding of this case is controlling here.

In its petition for review the taxpayer contends, in computing the amount of relief under § 722, that the Tax Court erred by applying the so-called "variable credit rule" contained in Regulations 112, 35.722-3 (d)(5).* It is petitioner's position that this rule is not based on the statute and therefore is unconstitutional. The petitioner, however, neither in its brief nor on the argument sustained that position.

Sec. 722(a) provides that in computing the constructive average base period income of a taxpayer no regard shall be had to changes occurring after the base period and during excess profits tax years unless such changes are the result of a program to which the taxpayer was committed during the base period. The Regulations implement this by providing that where increased earnings in an excess profits tax year are due to the expansion to which the taxpayer had committed itself during the base period, the extent to which the change in the capacity for production actually entered into the business of the taxpayer in such excess profits tax year shall be the extent to which a change in the productive capacity is deemed to have existed in December 1939. Thus, if not full

*See Appendix (C).

but only part productive capacity was attained in any one profit year, only part productive capacity would be allowed in computing taxpayer's constructive income during the base period.

Petitioner contends that in computing constructive income, full productive capacity should be allowed, whether such full capacity was actually attained during the excess profits tax year. Any other rule, says petitioner, would be unconstitutional.

The variable credit rule contained in the Regulations has been in effect for many years. It has been applied when appropriate upon the facts in numerous cases before the Tax Court.

Nielsen Lithographing Co. v. *Commissioner*, 19 T. C. 605;
Southern California Edison Co. v. *Commissioner*, 19 T. C. 935;
Yeast Products, Inc. v. *Commissioner*, 21 T. C. 308;
Lily Mills Co. v. *Commissioner*, 21 T. C. 900;
Springfield Tablet Manufacturing Co. v. *Commissioner*, 22 T. C. 35;
Journal-Tribune Publishing Co. v. *Commissioner*, 24 T. C. 1048;
R. J. M. Co. v. *Commissioner*, 24 T. C. 1032;
Hydraulic Press Manufacturing Co. v. *Commissioner*, 27 T. C. 278.

These Regulations set forth a reasonable rule for adjusting the taxpayer's constructive income average on the basis of production levels actually attained.

Appendix B

Petitioner in effect seeks to strike down a reasonable rule and to substitute a rule for adjusting constructive income average without reference to reality but merely on a hypothetical productive capacity—even though subsequent events prove the hypothesis incorrect. This we cannot do. See *Mutual Shoe Co.* v. *Commissioner*, 238 F. 2d 729, 734 (1 Cir. 1956) and *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 501 (1947).

The decision of the Tax Court is affirmed.

APPENDIX

(A) Sec. 7482. Courts of Review.

(a) *Jurisdiction.* The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

* * * * *

Sec. 7483. Petition for Review.

The decision of the Tax Court may be reviewed by a United States Court of Appeals as provided in section 7482 if a petition for such review is filed by either the Secretary (or his delegate) or the taxpayer

within 3 months after the decision is rendered. If, however, a petition for such review is so filed by one party to the proceeding, a petition for review of the decision of the Tax Court may be filed by any other party to the proceeding within 4 months after such decision is rendered.

(B) Sec. 6512(b)(1)

(b) Overpayment Determined by Tax Court.—

(1) Jurisdiction to Determine.—If the Tax Court finds that there is no deficiency and further finds that the taxpayer has made an overpayment of income tax for the same taxable year, of gift tax for the same calendar year, or of estate tax in respect of the taxable estate of the same decedent, in respect of which the Secretary or his delegate determined the deficiency, or finds that there is a deficiency but that the taxpayer has made an overpayment of such tax, the Tax Court shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Tax Court has become final, be credited or refunded to the taxpayer.

(C) Regulations 112 Sec. 35.722-3(d), pp. 120 and 121:

"* * * there are instances in which the business may not have reached its full level of normal operations during the *excess profits tax taxable years.* In such situations it would obviously be unfair to allow the use of a 'yardstick' based on full level of normal operations, for the measurement of earnings based on operations which have not reached that level." (Emphasis supplied.)

Appendix C

HELMS BAKERIES,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 14808.

United States Court of Appeals
Ninth Circuit.

Aug. 14, 1956.

Rehearing Denied Sept. 21, 1956.

Proceedings on petition to review a decision of the Tax Court, 23 T. C. 967, adverse to taxpayer. The Court of Appeals, Jertberg, District Judge, held that where taxpayer sought adjustment in excess profits taxes upon the basis of a change in its capacity for operation and productive capacity occurring within base period, and Tax Court found there was a change in taxpayer's productive capacity, it should also have made a finding as to whether or not if taxpayer's increase in capacity for operation as reflected by Tax Court's evidentiary findings, had been made before expiration of base period, a higher level of earnings would have been reached at the end of the base period, and if so, the amount thereof.

Appendix C

Petition for review dismissed in part, and remanded to Tax Court in part.

George T. Altman, Beverly Hills, Cal., for petitioner.

H. Brian Holland, Asst. Atty. Gen., Harry Marselli, Lee A. Jackson, Attys., Department of Justice, Washington, D. C., for respondent.

Before ORR and CHAMBERS, Circuit Judges, and JERTBERG, District Judge.

JERTBERG, District Judge.

This proceeding involves determination of Federal Excess Profits Taxes for the calendar years 1943, 1944 and 1945.

The petitioner, Helms Bakeries (hereinafter referred to as the petitioner) is a California corporation. It filed its tax returns, including its excess profits tax returns, for the years 1940-1945 with the Collector of Internal Revenue for the Sixth District of California.

The only issues presented to the Tax Court for decision related exclusively to the petitioner's right to relief under Section 722 of the Internal Revenue Code of 1939 for the taxable years 1943, 1944 and 1945. The taxpayer was in existence during the entire base period—1936 through 1939—and was entitled to use an excess profits credit based on income under the provisions of Section 713 of the code.

The pertinent sections before this court are Section 722(b) (2) and Section 722(b) (4).

Section 722(a) reads: "In any case in which a taxpayer establishes that the tax computed under this

subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. * * *"

Under Section 722(b) (2) relief is allowed if "the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry."

Under Section 722(b) (4) relief is allowed if "the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. * * *" It is also provided under that section that "if the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time.

* * *" The term "change in the character of the business" is defined in the section to include "a difference in the capacity for production or operation."

Specifically, before the Tax Court, the petitioner ascribed error to the Commissioner of Internal Revenue and rested its claim to the right to Section 722 relief for the taxable years in question, upon two grounds: (1) That its base period earnings were depressed by reason of a price war within the purview of Section 722(b)-(2); and (2) That it had increased its capacity for production and operation within the purview of Section 722(b) (4).

After the trial on the merits before the Tax Court, that Court handed down its findings of fact and opinion holding that petitioner was not entitled to any relief under Section 722(b) (2) or under Section 722(b) (4), and thereafter entered its decision in favor of the Commissioner. The opinion of the Tax Court bore a notation at the end reading as follows: "Reviewed by the Special Division". The Tax Court then entered its decision in the case as above indicated. Petitioner filed a motion to amend the findings of fact, which motion was denied. Thereafter petitioner filed a motion to vacate the decision of the Tax Court, and for reconsideration, and that motion was subsequently set for hearing before the Tax Court, and after hearing and submission of memoranda, the motion was denied.

The questions presented for review by this Court, as stated by petitioner, are:

(1) "Whether in computing relief from excess profits taxes, under Section 722(b) (2), I. R. C. 1939,

computation of the constructive average base period net income on a basis which recognizes and makes allowance for the fact that the taxpayer was a growing corporation may be denied because computation under a formula which also recognizes and makes allowance for the fact of growth is permitted under Section 713(f) of that code."

(2) "Whether the Tax Court denied petitioner due process of law in:

"(a) Substituting its arbitrary and capricious judgment—in the form of an ultimate finding 'that lack of productive capacity was not a factor which to any appreciable extent limited petitioner's sales'—for the judgment of petitioner's president and general manager where:

"(1) Said president and general manager, as found by the court, considered that there was an available market for the goods to be produced by the additional productive capacity;

"(2) Said president and general manager, as found by the court, was an experienced executive in the bakery industry whom it regarded as aggressive and foresighted; and

"(3) There is a complete absence of any other finding on this point.

"(b) Making the arbitrary distinction between a change in capacity which 'caused', and one which 'permitted', expansion and growth.

"(c) Failing to make an ultimate finding or other determination of fact on the issue of change

in capacity for operation, adequate data for computation thereof being contained in the evidentiary findings.

"(d) Failing to apply to petitioner the principle of 'back-cast' of income from 1939, the basis of growth being indirectly given effect through such back-cast principle, although it applied that principle in cases involving other taxpayers."

(3) "Whether the Tax Court properly and fully carried out the review by a special division required by Section 732(d), I. R. C. 1939, although (a) that court promulgated no rules of any kind under that section, (b) taxpayers were never informed of their rights and procedures, if any, in respect of such review, (c) the record contains nothing in respect of such review except the sole and simple fact that the findings and opinion had been reviewed by the special division, and (d) petitioner's motion to vacate and for reconsideration was denied by the Tax Court without consideration by the special division.

(4) "Whether this Court has jurisdiction to review the determination of the Tax Court to the extent to which the above questions are involved."

Petitioner does not challenge the findings of fact of the Tax Court, except the findings contained in the last two paragraphs thereof, which read as follows:

"Lack of productive capacity was not a factor which to any appreciable extent limited petitioner's sales.

"The excess profits tax paid by petitioner for the years in issue was not excessive and discriminatory.

Petitioner was not entitled to a constructive average base period net income which was large enough to produce a credit greater than the credit received under Section 713 of the 1939 Code."

Respondent concedes that this Court has jurisdiction to review the questions presented as to whether the petitioner has been accorded a review by the Special Division of the Tax Court in keeping with Section 732(d), but contends that this Court should decline to take jurisdiction of the petition for review in so far as it relates to all other matters attempted to be presented to this Court, namely, the points made with respect to the decision of the Tax Court as to the petitioner's right to relief under the provisions of Section 722(b) (2) and Section 722(b) (4) because of the prohibition contained in Section 732(c).

We will first consider petitioner's contentions in respect to Section 732(d). This section provides: "The determinations and redeterminations by any division of the Tax Court involving any question arising under section 721(a)*(2) (C) or section 722 shall be reviewed by a special division of the Tax Court which shall be constituted by the Presiding Judge and consist of not less than three members of the Tax Court. The decisions of such special division shall not be reviewable by the Tax Court, and shall be deemed decisions of the Tax Court."

The petitioner's contentions on this subject are summarized under paragraph 3 of its "Statements of Questions Presented for Review" supra.

The petitioner has misinterpreted the function of the "Special Division". The review by the Special Division required by Section 732(d) is not intended

to be similar to a review by an Appellate Court with the usual opportunity to submit briefs and to make oral arguments. Because of the complexities of the relief provisions of the Excess Profits Tax law, Congress provided for Special Divisions within the Tax Court for the purpose of reviewing decisions involving these abnormalities provisions. These Special Divisions were composed not only of experts in tax law, but of experts who were to keep abreast of legislation and construction of questions of law arising under these abnormalities provisions. When a Judge of the Tax Court is assigned to hear and decide a case which involves these abnormalities sections, his opinion is automatically reviewed by the Special Division assigned to review the particular section involved. This review within the Tax Court itself was discussed in Green Springs Dairy Inc. v. Commissioner, 4 Cir., 208 F. 2d 471, 476, where the Court said that the purpose of Congress in enacting Section 732(d) was not "to secure a reargument of the case but to assure a consistent and uniform application of the principles of the excess profits tax statute by a group familiar with the problems involved."

[1] The fact that the petitioner's motions to amend the findings and for reconsideration were denied by the Division, whose decision was approved by the "Special Division", does not establish that the function of the "Special Division" was usurped. In denying such motions, the Division simply refused to disturb the decision which the "Special Division" had already approved. We hold that the petitioner was not denied due process of law because it was not given

an opportunity to appear, argue, or submit briefs before the "Special Division".

The next point for consideration is whether or not this Court should decline jurisdiction because of the provisions of Section 732(c). This section provides: "If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711(b) (1), (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Tax Court."

[2] Petitioner contends that the determination of all remaining questions presented by it for review is not made necessary "solely by reason of * * * section 722" and hence the provisions of Section 732(c) do not prohibit review by this Court.

Petitioner argues: (1) That the question presented under paragraph 1 of its "Statement of Questions on Appeal" (supra) involve the application and effect of Section 713(f); (2) That the questions presented under paragraph 2, in all of its parts, involve the denial to petitioner of due process under the Fifth Amendment to the Constitution of the United States, and that as to part "d" thereof, there is also involved the duty of the Tax Court under Section 1117 of the 1939 Code. We will consider these points ad seriatim.

Under point 1, petitioner states that the Tax Court erroneously disregarded petitioner's growth because an adjustment for growth had been allowed petitioner under Section 713(f). On this issue the Tax Court

found that "The Excess Profits Tax paid by petitioner for the years in issue was not excessive and discriminatory. Petitioner was not entitled to a constructive average base net income which was large enough to produce a credit greater than the credit received under Section 713 of the 1939 Code." We do not construe the decision of the Tax Court in denying relief that it expressly or impliedly held, based on the foregoing finding, that the petitioner was precluded from receiving any relief under Section 722(b)(2), because it had received the benefit of Section 713(f). We construe the finding to mean simply that under the facts presented to the Tax Court, the petitioner failed to establish that any relief which the Tax Court could give under Section 722(b)(2) would result in a credit greater than the petitioner had already received under Section 713(f). We therefore hold that the determination of the question presented under this heading is made necessary solely by reason of Section 722(b)(2), and that, therefore, under Section 732(c), this Court is without jurisdiction to pass upon that issue.

Under point (2) above, petitioner argues that the decision of the Tax Court was arbitrary and capricious, contrary to the facts found by the Tax Court, and that the Tax Court failed to make a finding on a material issue presented to it.

Petitioner sought relief under Section 722(b)(4) "upon the basis of a change in its capacity for operation and production occurring within the base period." The Tax Court found that "During the base period there was a change in the productive capacity of the petitioner. Lack of productive capacity was

not a factor which to any appreciable extent limited petitioner's sales." There is no finding by the Tax Court on the issue of a change in the petitioner's capacity for operation occurring within the base period.

With respect to the change in petitioner's capacity for production occurring within the base period, the Court found that there was a change in the productive capacity of the petitioner's business during the base period; that the President and General Manager of petitioner was an experienced executive in the bakery industry prior to petitioner's organization in 1931; that during the period 1931 to 1939 petitioner made nine additions to its plant; that on December 15, 1931, petitioner completed the installation of its first traveling oven; that on April 9, 1934, petitioner completed the installation of its second traveling oven; that the installation of a third oven was completed on June 3, 1937; at that time, space was provided for the eventual installation of a fourth oven, and the electrical wiring, fixtures, plumbing and other connections were installed; that petitioner was financially unable to install a fourth traveling oven in 1937, even though its management considered that there was an available market for such additional production; that on December 5, 1939, petitioner completed the installation of its fourth and largest traveling oven; that during the base period the baking area of petitioner's traveling ovens increased from 1,260 square feet to 2,688 square feet; that during the same period petitioner acquired additional bread and cake machinery, bread and cake tools, and bread and cake fixtures for use with its increased baking capacity; that petitioner in 1937 spent $10,000 for electrical wiring and other con-

nections for the additional oven, but could not install the oven then because of financial limitations.

On this phase of the case the Tax Court relied on Green Spring Dairy, Inc., 18 T. C. 217 which the Tax Court stated "is strikingly similar to the case at bar * * *". The following quotation from the *Green Spring* case omitted from the opinion of the Tax Court in the instant case makes that case a poor reed on which to rely. The omitted quotation is as follows:

> "While petitioner experienced difficulty with its facilities toward the end of 1935, the difficulty lay in its distribution and storage facilities and not in its production facilities; moreover, corrective measures were taken before the end of 1935 to increase distribution and storage capacity through the opening of a branch station. Although there was undoubtedly a certain amount of congestion in petitioner's plant, we are satisfied that it had not yet reached the limit of its capacity, and that its sales or acquisition of new customers was not in any way impeded. Throughout these years petitioner's operation and management were in the hands of tried and capable businessmen, *who had the resources to construct a new plant earlier if it had been necessary, and we are unable to conclude that they did not act in time*". (Italics ours.)

In the instant case the Tax Court found that the petitioner could not install the additional oven because of financial difficulties which finding is directly

contrary to the statement in the *Green Spring Dairy* case in which it was stated that the taxpayer there had the resources to construct a new plant earlier if it had been necessary. Under a fair construction of the finding of the Tax Court there was an available market in 1937 for additional production.

[3, 4] In view of the evidentiary findings of the Tax Court on this subject, its conclusion "lack of productive capacity was not a factor which to any appreciable extent limited petitioner's sales" appears to be arbitrary and contrary to its own findings.

As above stated, the Tax Court failed to make a finding on the issue of a change in petitioner's capacity for operation (as distinguished from capacity for production) occurring within the base period. As above noted, petitioner sought relief upon the basis of a change in its capacity for operation *and* production. It would be a rare instance where productive capacity alone would produce income. In all but the most rare instances there must not only exist productive capacity, but also a market must be found or developed, in order to produce income. The Tax Court found that petitioner added in 1939, twenty-six franchise routes and five coach routes, which included its 1939 extensions to Ventura, Santa Barbara and San Diego counties; that petitioner always installed ovens in anticipation of further development of its markets; that to avoid offering stale goods to customers, it was petitioner's policy to get the oven capacity ready, and then develop the market, i. e., the routes; that during the period of July 1, 1939 to March 1, 1940, petitioner spent approximately $50,000.00 for suburban loading

rooms, and $79,000.00 for trucks, trailers, coaches and franchise cars, and that petitioner was committed to its 1939-1940 expansion program prior to December 31, 1939. The Tax Court should have made a finding as to whether or not, if this increase in capacity for operation had been made two years earlier, a higher level of earnings would have been reached at the end of the base period, and, if so, the amount thereof.

In light of the foregoing record in respect to relief sought by the petitioner under Section 722(b) (4), we are not precluded from assuming jurisdiction because of the provisions of Section 732(c).

Accordingly, the petition for review is dismissed for lack of jurisdiction in respect to the relief sought by petitioner under Section 722(b) (2) and remanded to the Tax Court for further consideration of the relief sought by petitioner under Section 722(b) (4).